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Central Intelligence Agency

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Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE**31 OCTOBER 1985****Mexico: Economic and Political Impact of the Earthquakes** [REDACTED]

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Summary

The two earthquakes that struck Mexico last month claimed between 8,000 and 10,000 lives and caused about \$3.5 billion in damage. Although the disaster will have little longterm effect on the Mexican economy, it will delay economic reform. On the positive side, Mexico City has gained a temporary respite from international creditors and probably has strengthened its case for additional international financial assistance. Domestic criticism of the government's handling of the relief effort is likely to mount; for comparison, Mexico's devastation, earthquake-related corruption, and public distrust do not come close to matching the levels associated with the Nicaraguan quake of 1972. The assistance Washington and private US citizens have rendered Mexico City in the aftermath of the disaster, despite initial Mexican reservations about accepting such help, probably will modestly improve the overall climate of bilateral relations for a brief period. [REDACTED]

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A Damage Assessment

The death toll from the quakes on 19 and 20 September is still rising. A number of estimates, including a recent UN survey, indicate the disaster claimed between 8,000 and 10,000 lives. Approximately 30,000 persons are known to have been injured--10,000 seriously--and over 50,000 were left homeless. Another 2,000 are missing and presumed dead. Of the more than 400,000 US citizens in Mexico at the time of the quakes, at least 10 have been confirmed dead and another 20 are missing. [REDACTED]

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Less than two percent of Mexico City was destroyed, according to Embassy and press reports. The Embassy estimates that of the approximately one million buildings in.

This memorandum was prepared by [REDACTED] of the Office of African and Latin American Analysis. Information available as of 31 October 1985 was used in its preparation. Comments and queries are welcome and may be directed to the Chief, Mexico Branch, Middle America-Caribbean Division, [REDACTED]

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the capital, approximately 3,000 were damaged. Of these, just over one third were demolished or are beyond repair. Areas outside the capital were less severely hit, although at least a half dozen central and western states sustained significant damage.

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Damage generally was less severe than originally feared. Nonetheless, we believe it will amount to about \$3.5 billion, close to the figure recently cited in a UN study. Mexico's international telephone and telex system was heavily damaged and could require up to \$1 billion of new equipment to restore service, according to the Mexican Government. Repairs to Mexico City's water system are likely to cost \$500 million, the Embassy reports. Another \$2 billion probably will be required to rebuild privately-owned structures and government facilities in Mexico City and elsewhere. Among government buildings destroyed were those of Budget and Planning, Commerce, Communications and Transport, and the Navy. According to the Embassy, foreign insurance companies will pay about \$540 million for property destroyed nationwide, of which about two-thirds will go to the private sector. Eighty percent of claims will be paid in dollars or other foreign currency.

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The quakes did little damage to the country's industrial and manufacturing infrastructure, although some 1,300 small-scale textile plants in the downtown area of the capital were destroyed. The country's petroleum facilities, largely concentrated in southeastern Mexico, apparently were virtually untouched. Only minor damage was reported to the country's transportation system or agricultural sector. Although adequate food supplies were available in the capital, some distribution problems arose, and the government received hundreds of complaints of price gouging on basic commodities, such as bread, tortillas, beans, milk, and sugar, according to the Embassy.

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The Relief Effort

The Mexican Government initially sought to play down the severity of the tragedy, according to Embassy and press reports. Apparently out of nationalistic pride, it did not request foreign assistance. [REDACTED] the de la Madrid administration went so far as to refuse an offer of sophisticated communications equipment at a time when the capital was virtually isolated from the rest of the world.

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In the immediate aftermath of the quakes, the United States sent rescue and damage assessment teams to Mexico. Washington also has donated at least \$4 million in cash, relief supplies, and equipment. Assistance from other governments and private organizations has been extensive, although falling short of Mexico's disaster-related needs. According to the Embassy, as of mid-October, 31 countries had contributed 1,088 tons of relief aid, and the government's National Reconstruction Fund had received over \$29 million in contributions, not including a \$50 million low-interest commodity loan from Japan. The IMF has announced that it is granting Mexico a \$300 million emergency loan for disaster relief; the World Bank is likely to provide a similar amount.

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Short-Term Economic Impact

The direct effects on Mexico's economy--which is suffering from falling oil prices, sluggish non-oil exports, and excessive government spending--should be relatively slight and felt for perhaps only six to nine months. Nonetheless, despite significant international relief assistance, Mexico City still will have to redirect a portion of the already strained budget toward the relief effort. Although the inflow of earthquake-related funds will temporarily create jobs and spur economic activity over this short-run, the positive impact of such activity will be negated by the approximately 150,000 jobs lost as a result of the earthquakes. According to Embassy reporting, for example, some 40,000 textile workers lost their jobs because their manufacturing plants were destroyed. The infusion of foreign exchange will provide a degree of relief to Mexico's immediate balance of payments squeeze, but price gouging and more rapid money supply growth are sure to contribute to rising inflation. We expect the psychological effects of the earthquake to depress tourism receipts--Mexico City estimates a \$300 million loss--even though major tourist centers largely escaped damage. Despite the disaster, our estimate for GDP growth for 1985 reflects minimal disruption and remains virtually unchanged at 3-3.5 percent. [REDACTED]

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Aside from financial considerations, international bankers also have political factors to consider. [REDACTED] lenders are well aware of the growing pressures on de la Madrid to declare at least a temporary moratorium on debt payments. These radical views have been endorsed not only by Mexico's leftist opposition parties, which have long taken such a stance, but also by the powerful President of the Confederation of Industrial Chambers, a number of labor unions, several large business organizations, academics, and at least one state legislature. Nonetheless, de la Madrid has stated that Mexico will continue to honor its external debt obligations. The President's bottom line, however, is that the economy must grow if Mexico is to meet its debt obligations. [REDACTED]

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Longer-Term Economic Implications

Domestic Adjustments. By causing planned economic reforms to be postponed, the earthquakes will contribute indirectly to de la Madrid's economic adjustment problems. Much-needed investment in key areas, most notably the petroleum sector, will have to be sacrificed as government expenditures are redirected to the rebuilding effort. In addition, by delaying planned cuts in key subsidies until sometime next year, Mexico City is worsening both the eventual inflationary impact of price hikes and adding a further drain on government coffers. As the government's fight against inflation becomes stymied, we believe there will be increased pressure to boost wages next year.

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As a result, de la Madrid is likely to renege again on his promise to end the slide in real wages. Perhaps more important, as higher prices push up domestic interest rates, the government's already onerous task of servicing its internal debt will worsen and much-needed private investment activity will be further depressed. [redacted]

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Debt and Foreign Borrowing. Mexico City has officially informed foreign lenders that as a result of the earthquakes its new money requirement for 1985-86 has grown to nearly \$5 billion--far above the \$2.5 to \$3 billion requested earlier [redacted]

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[redacted] Nonetheless, Mexican officials now privately estimate that the country may need as much as \$11 billion in new financing before the end of next year. This figure has been revised to reflect higher-than-expected capital flight and a likely drop next year in oil prices resulting from Saudi Arabia's decision to increase production.

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We believe that by linking the earthquakes to new money and by effectively posturing as the moderate leader among Latin debtors--as well as the potential trigger to a more radical approach--Mexico City will receive much of the \$5 billion it originally sought after the disaster. Since Mexican officials realize creditors would not consider an amount significantly higher, appeals for the additional financing probably will be delayed until the second half of next year. [redacted]

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Based on our assumptions about new lending, oil prices, non-oil export performance, and the eventual implementation of budget-cutting measures, we do not expect to see real growth in the Mexican economy next year. Moreover, inflation will remain stubbornly high at about 55 to 60 percent. Although de la Madrid probably will use the earthquakes to explain this poor performance, we believe a significant portion of the blame lies in the government's spending surge before midterm elections last July.

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Political Fallout

[redacted] the government's performance in the aftermath of the earthquakes has increased popular dissatisfaction with Mexico's leaders and the political system. The initial tendency of Mexicans to rally behind the government has given way to questioning of its handling of the crisis. [redacted]

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Leftist parties have particularly called attention to the plight of the homeless and the fact that disaster victims have received little relief assistance. In early October, a recently-formed group, the Popular Front for Solidarity and Reconstruction, headed by long-time Mexican human rights activist Rosario Ibarra, sponsored a peaceful march in capital. According to the Embassy, approximately 15,000 Mexicans participated, protesting the government's handling of the disaster. [redacted]

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Despite these charges and protest activities, the left has been unable to capitalize on the situation, largely because its efforts are viewed by many as self-serving. According to the Embassy, in the aftermath of the earthquakes a number of self-help committees were formed in various neighborhoods of the capital and have been more effective in assisting those in need than either the government or leftist groups. [REDACTED]

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The government still could face political difficulties, however, if wide areas of the capital remain without water and other public services for an extended period. Similarly, problems would grow if the government proceeded with controversial plans to relocate some citizens rather than rebuild the neighborhoods most seriously damaged. Political protests may occur in the weeks ahead, but such unrest is unlikely to get out of hand because the military and other security forces appear to have the capability and will to put down any localized disturbances. [REDACTED]

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Mexico's experience in the aftermath of the earthquakes is unlikely to parallel that of Nicaragua in the early 1970s, when Managua's mishandling of the relief effort fanned public dissatisfaction with the Somoza regime and indirectly contributed to its downfall in 1979. The earthquake that virtually leveled Managua in 1972 was far more destructive proportionally than the ones that recently hit Mexico City. In addition, Mexican authorities appear more sensitive to public attitudes and, in view of developments in Nicaragua, presumably will seek to minimize disaster-related corruption. [REDACTED]

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Although the assistance provided by Washington is likely to create a temporary reservoir of good will, this is likely to dissipate as Mexico attempts to cope with its mounting economic difficulties. The disaster and related reconstruction costs almost certainly will increase Mexico's financial difficulties in the short-term, making Mexico City all the more dependent on Washington's help to obtain external assistance. This could influence the Mexicans to become more cooperative on border, narcotics, and other issues of mutual concern in the near term. Such a positive attitude is likely to be reflected in discussions de la Madrid is tentatively scheduled to hold with President Reagan in early 1986. Nonetheless, we believe that the highly nationalistic sentiments of Mexico's leaders will inhibit any longterm warming in bilateral relations. [REDACTED]

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